



**THE NEW GREEN ECONOMY:
APPROACHING A THRIVING
LEGAL CANNABIS INDUSTRY IN
BRITISH COLUMBIA**

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01

3 - 7

ECONOMIC OVERVIEW OF ILLICIT MARKET
CANNABIS IN BRITISH COLUMBIA

02

8 - 11

AN ECONOMIC ANALYSIS OF LEGAL CANNABIS IN
BRITISH COLUMBIA

03

12 - 19

THE GREATEST CHALLENGES TO LEGAL CANNABIS
PROLIFERATION IN BRITISH COLUMBIA

04

20 - 27

LESSONS FROM AMERICAN MARKETS FOR LEGAL
CANNABIS IN BRITISH COLUMBIA

05

28 - 34

COSTS AND OPPORTUNITIES OF DIFFERENT LEGAL
CANNABIS MARKET MODELS IN BRITISH COLUMBIA

06

35 - 41

THE EVIDENCE-BASED CASE FOR A HYBRIDIZED
SUPPLY CHAIN FOR LEGAL CANNABIS IN
BRITISH COLUMBIA



ECONOMIC OVERVIEW OF ILLICIT MARKET CANNABIS IN BRITISH COLUMBIA

It comes as no surprise to anyone that Canadians consume a heck of a lot of weed. The government estimates that in 2017, 4.9 million Canadians spent over an estimated \$5.5 billion on cannabis, consuming 773.4 tons at an average price of \$7.15 a gram.

Over 90% of this was non-medical - in other words, illegal - consumption.

This black-market cannabis is produced across the country by households for personal use, designated medical growers with excess product and by grow-ops of varying size and sophistication, and is distributed through vast, decentralized networks of friends & family, dealers, brokers, and dispensaries.

Canada is also a significant net exporter of its illicit cannabis, with over 20% of total production exported in 2017 at an estimated \$1.2 billion in value.

British Columbia has long played a unique and renowned role in Canada's cannabis black market.

From the 1960s draft-dodgers from America's West Coast migrated north, discovering British Columbia's fertile land and ideal microclimates for the cultivation of cannabis. With limited policing against growers and an influx of anti-establishment settlers, 'BC Bud' - a term first used for a US prohibition-era beer smuggled in vast quantities south across the border - become synonymous with the province's plentiful and high-quality cannabis.

Decades on, despite increased enforcement and the advent of a national medical-use industry the brand has endured, resulting in a province with a taste and a tolerance for cannabis, and a concentration of experience, knowledge, passion and skill amongst the provinces' many, still largely illicit, growers.

CONSUMPTION

British Columbians are markedly canna-curious, with 20% of citizens having consumed cannabis in the last three months, against a national average of 15%.

This represents an estimated 725,000 cannabis users consuming in the region of 91 metric tons a year and spending more than \$830 million in the process. BC is beaten only by Nova Scotia in per capita cannabis consumption, which at 24.6 grams per year is more than 15% higher than the national average.

Unsurprisingly given BC's long relationship with cannabis, only 7.9% of product consumed in the province was obtained with a medical document in 2017, placing 92% of BC's cannabis consumption from the black market.

PRODUCTION

British Columbia is Canada's chief cultivator of cannabis, accounting for 100% of in-province consumption and 36.6% of the nation's total cannabis production.

The exact size of BC's (predominantly illicit) cannabis market is not easily quantified, though estimates place it at between \$2 to \$7 billion. With experimental modelling, Statistics Canada pegs the 2017 retail value of BC's total cannabis market at over \$2.25 billion.

Although conservative by other estimates, this figure makes BC's black-market cannabis market three times larger than the provinces' greenhouse industry, 50% bigger than BC's farmed salmon industry, and three-quarters of the size of the province's film and TV production industry.

According to Statistics Canada's estimates, 37% of BC's cannabis is consumed in-province, and just over a quarter is sold to other provinces. The remaining 35% is sold illegally abroad.

With BC cannabis exports valued at nearly \$800 million last year, the province accounts for three-quarters of Canada's international cannabis trafficking, and exports more illegal cannabis to the world than it does salmon. However, alternative studies place the volume and financial value of BC's black market cannabis exports significantly higher still.

MICRODATA

Black market BC cannabis growing operations have grown in both size and sophistication since the 1990s, following a shift in production from outdoor grows to predominantly indoor operations.

Studies using data from BC Hydro suggest that there are over 13,000 active commercial indoor cannabis operations in BC. These represent the largest source of BC's black market cannabis and are supplemented with product from outdoor grows and unlicensed personal cultivation.

An alternative measure using the number of Colorado's cannabis jobs as a proxy suggests that BC's black-market cannabis industry supports an estimated 13,700 jobs across the province with wages in excess of \$600 million. These jobs include growing, processing and the production of items such as oils and edibles, along with further employment in ancillary industries as diverse as retail, management, marketing, and legal services. The vast majority of these jobs also pay significantly higher than the BC minimum wage of \$12.65.

SHADES OF GREY

British Columbia's billion-dollar, black market industry can be understood in a number of ways.

By one interpretation, BC's thousands of grow-ops and international trafficking operations represent a dangerous and harmful criminal enterprise.

There are undeniable social, health, and criminal costs associated with the illegal production of cannabis. Cannabis is the most trafficked drug in the world, with illegal trade reportedly contributing \$7 billion to organized crime in Canada alone. And of the 650+ organized crime groups operating in Canada, over half are known or suspected to be involved in the cannabis black market.

Black market cannabis is frequently grown in properties ill-suited and inappropriately fitted for horticultural use. A lack of safety regulation and high electricity use contribute to increased fire risks, alongside other concerns such as the theft of utilities, contamination of water, poor ventilation, and local disturbance. Black market products are unregulated, with zero safeguards for the accurate reporting of cannabinoid levels, or the testing of mould, pesticides, and other contaminants. Black market growers can also generate significant levels of illicit, untaxed revenue, which is then further obscured through additional channels to avoid detection.

However, others challenge an unequivocally negative portrayal of BC's cannabis production. Claims that the industry is dominated by organized crime have been criticized as unsubstantiated and misleading, and there is little evidence of an established criminal hierarchy of cannabis distribution in Canada or more than isolated instances of threat within the industry.

To the residents of towns like Nelson in the Kootenays region of BC, the unlicensed cannabis industry is seen in a very different light. In these rural, predominantly agricultural areas, cannabis production can serve as a valuable economic driver, supporting jobs and opportunity in communities where traditional industries like lumber and mining have declined.

In these regions, cannabis cultivation offers well-paid jobs with flexible hours and profits returned to the community. Cannabis-related business can account for an estimated 15% - 30% of such local economies, providing income for growers and their employees, ancillary industries such as dispensaries and equipment suppliers, and other local sectors such as retail, restaurants, and real estate. In the words of a city councillor from Nelson, hub of the Kootenays' weed industry, cannabis' contribution to the local economy "just can't be overstated".

While the cultivation and sale of unlicensed cannabis is federally illegal, many of BC's industry has operated in somewhat of a legal grey-area - perhaps growing cannabis legally as one of BC's 4,150 designated growers and selling excess product to friends or dispensaries - or as a tax-paying, registered enterprise producing unlicensed products such as edibles or vape pens. Cities such as Vancouver and Victoria have recognized the significant role of cannabis within their communities, issuing pre-legalisation business licenses to certain dispensaries that, while still federally illegal, comply with specific local stipulations.

CONCLUSION

There is no single, 'correct' interpretation of BC's cannabis black market. It is diverse and multifaceted, encompassing opportunists, profiteers, and career criminals as well as entrepreneurs, activists, and educators.

Regardless of one's interpretation, the federal legislation of cannabis represents a once-in-a-lifetime opportunity to transition BC's \$2bn+ industry from the criminal to the legal, and to build legitimacy and opportunity for those who embrace the new, regulated market.

The crucial question for the province is how best to do so - how to eliminate continued, wilfully criminal activity while generating new jobs and innovation, a source of taxable income, and a high-quality product - BC Cannabis - that is so rightfully known throughout Canada and across the world.



**AN ECONOMIC
ANALYSIS OF LEGAL
CANNABIS IN BRITISH
COLUMBIA**

The legalization of cannabis represents a significant economic opportunity for Canada, with the market worth up to \$7.17 billion in 2019, according to Deloitte.

And while not even the most optimistic of lawmakers is expecting Canada to transition to a wholly-legal cannabis market overnight, more than half of sales - \$4.34 billion - are expected to come from legal channels in the first full year of legalization. New Frontier Data predicts that Canada's adult-use market will be worth \$9.2 billion by 2025, with the legal industry growing in size to \$5.2 billion in 2022 and \$7.7 billion by 2025.

With its thriving cannabis black market, BC is uniquely positioned to capitalize on the opportunities of legalization - and yet, paradoxically, it also has the most to lose.

A successful legal industry could generate tens of thousands of jobs, hundreds of millions in tax revenue, and a potential economic upside of billions of dollars for BC.

However, BC's current model of cannabis distribution and retail risks stunting the growth of the nascent new industry while undermining the incentives for consumers to purchase through legal channels. The following article will examine the provincial opportunities that legalization offers, followed by the extent to which provincial regulation imposes roadblocks to the adoption of a vibrant, legal industry.

LET A THOUSAND FLOWERS BLOOM

BC's long association with cannabis and its powerful combination of climate, culture, activism and entrepreneurialism stand it in good stead to reap the opportunities of a legal cannabis industry.

Taking the current black market as a base, an estimated 15,000 jobs could be created in year one of the legal provincial industry, with taxable wages in excess of \$620 million. Yet with the legal cannabis industry estimated to create 150,000 cannabis jobs across the whole of Canada, the total number of BC jobs could easily exceed these black-market benchmarks.

Evidence of the interest in - and opportunity within - the legal market is clear: the job site Indeed report that cannabis industry hires now account for 1 in every 400 job postings on the site, with BC ranking top for relative job seeker interest, and second only to Ontario for the number of cannabis-related jobs available.

More so than any other province, BC also stands to gain from the introduction of federal micro-licences, which offer growers a route into the legal industry with less demanding capital and operational requirements than those of a standard licence, as well as a one-time genetics transfer of black-market and unlicensed strains into the regulated system. With over 10,000 illicit grow-ops estimated across BC, even a small percentage of cultivators and processors transitioning to the legal industry would result in a significant uplift to the number of licenced producers in BC, and with it a commensurate increase in legal output and opportunity.

There's likely to be plenty of consumer-driven activity, too - the number of BC cannabis users is expected to rise from 750,000 to 816,000 thanks to legalization, with consumption growing to over 100 tons per year and total cannabis spend increasing by up to 58%. With two-thirds of current cannabis users looking to purchase in the legal market, BC represents a large and lucrative market for LPs as well as potential retailers.

THE SOCIAL NETWORK

But a healthy cannabis ecosystem is so much more than a roll-call of LPs or a competition for retail square footage.

A legal, regulated industry generates opportunity for a diverse range of ancillary and tangential businesses across the province - from testing labs to genomics and software development to higher education, compliance, security, construction, tourism, and law. As Silicon Valley and other regional powerhouses show, this clustering of industries promotes collaboration, accelerates innovation, facilitates knowledge creation and forms the foundation of a diverse, competitive ecosystem.

Deloitte suggests that Canada's ancillary cannabis market alone could be worth upwards of \$20 billion. If BC can leverage its assets, harness the entrepreneurialism of its population and create the right conditions for growth, the province could be home to a new, fully-legal industry worth several billion dollars a year.

TAX TAKE

Although frequently underplayed in Canada's public discourse, legalization also represents a significant new revenue stream for government - especially so for the provinces, who are expected to capture up to 70% of industry profits. It might seem gauche in the Great White North to covet the revenue-generating abilities of cannabis (though widely accepted for tobacco and alcohol), but it would be a huge mistake to overlook a successful cannabis industry's contribution to public coffers.

Under a revenue-sharing agreement with Ottawa, the provincial government will receive a 75% share of the excise tax levied on cannabis production in BC. From this, the province expects to receive revenue of \$75 million in the first full year of legalization.

In addition to this, the provincial government collects 7% PST on retail sales, a 15% markup on wholesale cannabis sales, license application and renewal fees, and net revenue from the publicly-owned online and retail stores. In all, total provincial revenue from the legalization of cannabis is expected to reach upwards of \$110 million annually.

A vibrant legal industry will also bring in secondary tax revenues by way of provincial payroll and corporation tax, as well as a wider uplift in general tax receipts from ancillary

business activity, new migration to the province, and spending on goods and services across the board.

The BC government is yet to announce how it will use its new revenue stream, or the cost of establishing the province's regulatory regime. However, cannabis tax take can be used to cover the regulatory costs of the industry and to support public health and educational initiatives, as in the case of Oregon and other US states with legal cannabis industries.

BC CANNABIS: THE NEW BC VQA?

In time, a legal, regulated cannabis industry could - and should - become an integral part of BC's identity, as celebrated as other provincial industries like forestry, mining, tech - and craft beverages.

Current cannabis sales already surpass those of spirits in Canada and approach the \$7 billion spent annually on wine, while BC's cannabis sector is already comparable in size to that of the province's wine industry, which contributes \$2.8 billion a year to the BC economy.

BC's wineries today produce over 80 varieties of grape, with the 900+ vineyards across the province's nine official wine regions welcoming more than one million visitors annually. Just as the Okanagan Valley terroir is celebrated across Canada and beyond, why should not, with the right regulatory environment and support, the Fraser Valley or Vancouver Island also be celebrated for the production of a premium, recreational, plant-derived product?

BC TRAILBLAZER

Legalization has given BC the chance to foster regions of cannabis-infused creativity and entrepreneurialism - and in doing so generate thousands of secure, well-paying jobs, hundreds of millions in tax revenue and billions of dollars of wider economic activity.

BC has the opportunity to lead Canada, and the world, in the production of regulated, high-quality cannabis - an opportunity that provincial politicians, policymakers and regulators should help the province embrace wholeheartedly.



**THE GREATEST
CHALLENGES TO
LEGAL CANNABIS
PROLIFERATION IN
BRITISH COLUMBIA**

BC's legal cannabis industry will only truly succeed if the province's black market is also simultaneously eroded and replaced. This requires a dual switch - of consumers to legal retail channels, and of illicit production into the regulated industry.

Provincial governments have a significant role to play in facilitating the success of legalization. Canada's federal cannabis policy is predicated on public health and restricting access rather than commercial opportunity, but if too cautious an approach to legalization is pursued at a provincial level, both public health and economic opportunity will be undermined by the persistence of an unregulated, unrestricted black market.

In this respect, BC's sophisticated black-market is both a blessing and a curse; with cannabis use and cultivation already firmly established in the DNA of the province, there is less incentive for citizens to embrace the legal market if the economic opportunity or quality of experience is not there.

Despite the vast pool of talent, experience and passion for the cannabis industry in BC, neither the elimination of the black market or a growth of a healthy, competitive industry will fully come to pass if the regulatory and economic climate does not allow for it.

CONSUMER-SIDE CONSIDERATIONS

Any serious attempt to erode demand for black-market cannabis needs to provide consumers with the opportunity and incentive to purchase through legal channels.

While the majority of Canadian cannabis users would like to make their purchases in the newly-legal marketplace, making a real dent in black-market demand requires the conversion of BC's heavier users: weekly and daily cannabis users account for 98% of total cannabis consumption, yet only 37% of daily users reportedly plan to purchase through legal avenues.

Price:

The price of legal weed is widely acknowledged as a key determinant of its success in eroding the black market. Luckily, Canadians both expect to and are willing to pay more for legal recreational cannabis - up to a point. The exact premium that consumers are willing to pay in the long run is unknown, however, with the Parliamentary Budget Officer estimating that a three-dollar per gram premium for legal weed over the black market price will see the legal market share fall to 42 per cent.

The legal retail cost per gram is determined by a range of factors, including LP's costs of production, provincial wholesale models, retailer's margins and the level of taxation. Provincial governments can influence the price in several ways, including via a wholesale markup, minimum retail prices, and provincial sales tax. Cognisant of their influence, the BC government has not looked to impose overly onerous levels of taxation and has reportedly worked to keep wholesale prices low.

However, a report issued by Statistics Canada in January 2019 found that after five years

of falling cannabis prices, three months of legalization has resulted in 17% increase in the price of cannabis - with black market cannabis costing an average of \$6.15 a gram, compared to \$9.70 for legal weed. In the long-run, the price of legal cannabis will likely fall as competition increases, more retail stores open and greater product choice becomes available. However, based on the Parliamentary Budget Officer's previous estimations, a permanent price differential of this size between the licit and the illicit market would lead to the legal industry capturing less than half of the total cannabis market.

While price is an important consideration of black market use it is by no means the only one: In BC in particular, issues of culture, choice and convenience are also crucial in determining the success of the legal market.

Variety:

Despite pop culture stoner stereotypes, cannabis users represent a diverse cross-section of society. Legal retailers therefore need to cater all cannabis-consuming demographics and offer cannabis products in varying forms, price, and potency, with a showcase of premium and craft cannabis products alongside more mass-market, value offerings.

More than half of those who plan to continue using the black market claim that being offered a better variety of products at a range of different price points would tempt them into the legal market - giving a strong incentive for provincial governments to place a premium on consumer choice.

Competing with the variety of BC's black market is no mean feat, with illegal dispensaries and delivery services offering hundreds of products and dozens of strains each. Depending on their inclination, consumers can source pre-rolled joints, concentrates, vapes and edibles, an ounce for under \$100 or 'premium' flower for \$14 a gram and more.

In contrast, the variety in BC's legal market is partially defined by the federal government - who will not regulate a range of concentrate and edible products until October 2019 - and the province's monopoly wholesaler, the Liquor Distribution Branch (LDB).

The LDB reports that it is 'engaged' with dozens of licensed producers to offer more than 150 products online. The LDB claim that their agreements secure a 'volume, variety and quality' of legal products for the province : How consumers feel these measure up to black market offerings - and the many thousands of legal products available in US states like Colorado and Washington - once the novelty of legalization wears off remains to be seen.

Convenience:

The provincial governments also decide through which channels consumers can access legal cannabis. Here, too, BC's legal market may struggle to compete with the flexibility and convenience of black market offerings.

Just as they are diverse in demographic, lifestyle and cannabis use, so too do consumers desire a range of options for the purchase of cannabis.

Over half of consumers would like to purchase their legal cannabis from either a government-run or private retail store: in this respect BC has them covered, with the province adopting a 'hybrid' model allowing an uncapped level of public and private retail stores similar to that in alcohol.

However, 48% of users would also like to purchase cannabis direct from a licenced producer or manufacturer's store. Here, BC consumers will have less luck, with provincial regulations prohibiting both 'farm gate' sales - where consumers can make on-site purchases direct from a licenced producer - and the vertical integration of producers and retail stores.

Recreational users are further frustrated in their choices for online sales. Whereas medical patients can continue to purchase product online from an LP of their choice, recreational users are limited to a single source: The LDB site.

This is despite the fact that a third of recreational consumers would like to purchase their cannabis online direct from an LP or a private retail website, while a quarter of consumers would like to purchase via an LP or retailer's app: these too are prohibited by the BC government.

'On demand' delivery services, which proliferate across metropolitan areas of BC, are also predictably banned.

At the outset of legalization, BC consumers had just two options for the purchase of legal cannabis: a sole, government-run retail store in Kamloops, and the government website. Three months in and despite over 400 retail applications submitted, the grand total of 8 have so far been approved.

Anything from poor design, technical problems and delays in delivery could result in a long-term aversion to the government site, with disgruntled consumers happy to turn to one of the many prevalent, well-stocked and highly convenient online dispensaries or delivery services already operating in BC. While BC Cannabis Stores has so far satisfied provincial customers, Ontario Cannabis Stores did not pass first month of legal sales so unscathed, attracting the accolade of the 'worst dealer ever' with only 60% of customers happy with their experience.

In the long run, BC's hybrid approach to retail stores should allow the number of legal, licensed shop fronts to rival (and exceed) the hundreds of dispensaries previously in operation, although many have warned that overly-restrictive licensing criteria and municipal restrictions place a significant check on the number of potential stores. For now, BC must contend with just a handful of retail locations while, neighbouring Alberta is home to over 70.

Supply:

The shortages of legal weed widely expected at the onset of legalization have come to pass, as the handful of LPs tasked with supplying the nation's legal cannabis encounter supply-chain issues, teething troubles and an exceptionally steep learning curve. Such problems are not unique to Canada, and characterised the start of legal recreational markets across the USA.

However, the problem is likely to be exacerbated in provinces like BC by the provincial government's hold on supply. In US states, the supply and distribution of cannabis is left to the market. Retailers are at liberty to order from cultivators and processors they please - allowing individual stores and producers to act quickly when supply is tight, and make product available as soon as it is ready.

In BC, the government's wholesale monopoly places the onus on the LDB to order the right volume and variety of product, and on the limited number of suppliers to produce and deliver it on time. By eradicating the multiple supply chains that naturally occur in a marketplace, the LDB's wholesale monopoly introduces a central bottleneck and a single large point of failure.

Such problems have already come to pass in Newfoundland and Quebec, where the government controls both the provincial supply chain and retail stores and locations have been forced to close due to shortages of supply.

Early setbacks in legislation are no way insurmountable - but the potential shortcomings of centrally-planning BC's entire cannabis supply while restricting the number of legal avenues available to consumers certainly risks entrenching an indifference or disdain towards the legal market that may prove hard to shift in the months and years to come.

PRODUCTION-SIDE ISSUES

It's not just BC's legal retail market that may struggle to find its footing.

BC's licensed producers do not enjoy the market penetration of its black market growers, while within the province the government's restrictive distribution model denies producers the opportunity to sell directly to consumers.

Even with a unique selling point, strong product and a great story, BC producers will have their work cut out for them under the current system.

The Beasts from the East

BC has long been Canada's prime producer of cannabis, currently accounting for nearly 40% of the nation's output. But BC's black market lead position is not replicated in the legal industry.

Currently, only 33 of the 146 licensed facilities sites - that's just over 20% - are situated in BC, as compared to 78 established in Ontario. Of the 71 sites with a sales licence, less

than 25% of them are based in BC. And of the 409 cannabis site applications live under the new licensing system, , 102 are from BC; a further 144 from Ontario, 51 from Alberta and 68 from Quebec.

With legalization, BC producers for the first time experience real competition from cannabis from beyond the province: of the LDB's initial supply agreements, less than half are with producers based solely in BC. Across the other provinces too, supply agreements are similarly dominated by firms with headquarters and cultivation sites in Ontario.

The proportion of BC-based producers is likely to increase with the take-up of micro-licenses; however, applications only opened on October 17th and follow an approval process of several months. Until they are approved, would-be microgrowers are precluded from the legal market, while larger, well-funded firms can compete for market share in the early days of legalization.

BC producers should in no way shy away from or expect to be protected from inter-provincial competition: if BC bud is as good as its proponents claim then the quality of product should speak for itself.

But Canada's new legal framework is not a free market, and does not look to replicate the black market system that many are used to. The barriers to success are significantly higher, but if BC producers don't seek to engage in this legal market then BC bud will lose its crown, or else be known as a black-market blight on an otherwise legitimizing industry.

(Don't) shake yo tail feathers

Federal regulations impose stringent restrictions on the promotion and packaging of legal cannabis, including plain packaging with mandatory labelling and warnings, and little scope to differentiate between products and producers. These restrictions apply universally to LPs, but are arguably particularly detrimental to cultivators with a niche or unique offering (such as sungrown or organic cannabis), or a distinct story to craft.

With so much cannabis consumption currently in the black market, brand identity so far has little impact on Canadian consumer preferences with only 16% consumers pre-legalization considering a brand name important. This offers a hidden opportunity for producers to gain an edge on the competition: those that can create a direct, positive and meaningful relationships with consumers, and who develop mechanisms to collect user feedback and share information are likely to capture early customer loyalty and brand awareness.

Within BC's retail model, however, opportunities for such direct marketing in the recreational market are scant; prohibitions on farm gate sales, vertical integration and online LP to consumer sales sever the connection between cultivator and consumer, and replace the link between retailer and LP with a government wholesaler.

PROVINCIAL MONOPOLY DISTRIBUTION

In a model of distribution unique to Canada, every province except for Saskatchewan has chosen to regulate the supply and distribution of cannabis via a government monopoly wholesaler. This body is the gatekeeper of the province's supply chain, and has the sole authority to sign supply agreements for recreational cannabis with licenced producers.

These crown corporations therefore hold the keys to their province's cannabis kingdoms. If LPs cannot secure an agreement with one of the handful of wholesalers, they risk being deprived access to customers, regardless of whether market demand exists for their products.

This represents a particular risk for the smaller, premium and craft producers who may choose to operate in BC. At least at the outset, the priority for BC's Liquor Distribution Board and other provincial wholesalers has been to secure an adequate volume of legal cannabis, prioritising sizeable supply agreements at a low cost per gram to compete with the black market. This is certainly an understandable approach, but threatens overlooking and disadvantaging smaller, craft cultivators in the long-run.

The design of BC's provincial cannabis distribution means that LPs cannot simply solicit retailers for shelf space or establish a store to sell their own products. If provincial wholesalers do not choose to significantly expand their supply agreements or take a risk on smaller, more premium and boutique producers, then LPs lose their only legal route to market.

CONCLUSION

Legalization undoubtedly presents a huge opportunity for BC, and the province has the resources, people and passion to take the challenge on. But sheer enthusiasm alone will not be enough to replace today's vibrant black market industry with an equally successful regulated one.

Relatively little attention has been given so far to the crucial role that the provincial government plays in the design and ultimate success of BC's legal cannabis industry. It is far from glamorous, yet decisions regarding cannabis supply and distribution - which producers have access to the consumer market, and which products consumers can buy and where - will define the effectiveness of BC's legal industry, both in generating jobs and opportunity and in eliminating the black market.

Perhaps more so than in any other province, BC needs provincial regulation that maximises the choices available for its producers and consumers.

If BC producers do not have a meaningful opportunity to compete for customers - and consumers are restricted in access and choice for legal cannabis, then BC's black market economy, with its trappings of familiarity and convenience, may well endure. While this may continue to provide jobs and generate output, it undermines the chance for true

product innovation and industry growth, and goes as far as to undermine any success of the national legalization experiment.

Until now, the concerns over BC's cannabis model have been largely theoretical. But as the weeks of legalization turn into months, early data starts to paint a picture - and it is a bleak one for BC's legal industry. While Ontario, Quebec and Alberta all took around \$20 million in sales in the first six weeks of legalization, BC managed a paltry \$3.3 million. And while the three provinces spent an average of \$1.50, \$2.50 and \$4.50 on cannabis per person respectively, British Columbia's spending per capita was the lowest across Canada by a significant margin, at just \$0.68.

A lack of retail stores and BC's heavily-entrenched black market have led to 'horrifying' retail figures in the words of one executive, warning that if the province cannot deliver on legal sales, then LPs will simply prioritize business with those which can. Clearly, the need for policymakers to reconsider BC's approach to legal cannabis is real, and the timing pressing. Fortunately, BC's regulations aren't set in stone - with a number of options for expanding access for producers and consumers which could help the province's industry thrive.



**LESSONS FROM
AMERICAN MARKETS
FOR LEGAL CANNABIS
IN BRITISH COLUMBIA**

While Canada is only the second country in the world to legalize cannabis, it has not done so in a cultural vacuum. Nine US states have legalized recreational use since 2012, and their experiences, perks and pitfalls in doing so offer valuable insight into what can be expected for BC's own legal industry.

The USA's three oldest recreational markets - Colorado, Washington and Oregon - provide a useful point of comparison for BC. As the most mature adult-use markets in the world, the three states yield a rich source of data and offer the strongest indicators of economic and commercial trends. Combined, the states accounted for over 40% of legal US sales last year, and with the population size of each state comparable to BC, they provide a helpful benchmark against which the province's industry can be compared.

While each state has a unique regulatory, retail and tax regime, broad themes - across job creation, product choice, price and black market erosion - are evident. These similarities between the states also highlight distinctions between the Canadian and American models of legalization, and what these differences might mean for the success of the legal industry in BC.

SALES AND TAX REVENUE

Since legalization, Colorado, Washington and Oregon have all enjoyed increasing sales of legal cannabis - and with this, rising tax revenue.

The first state to start recreational sales in January 2014, Colorado (population 5.6m) has spent more than \$5.5 billion on legal weed to date with \$1.5 billion of sales (c. \$1.95bn CAD) in 2017 alone. With a 15% excise tax and a 15% marijuana sales tax, Colorado has raised nearly \$816 million (\$1.05bn CAD) in taxes, licenses and fees since legalization. Tax take continues on an upward trend, with the state collecting nearly \$250 million in 2017, and \$23 million in September 2018 alone.

Washington (population 7.4m) was the second state to begin recreational cannabis sales in July 2014. At the onset of legalization, the state imposed a 25% excise tax on each stage of cannabis cultivation, processing and retail, before transitioning in July 2015 to a flat 37% excise tax at the point of sale, plus state and local sales tax. In the 2017 fiscal year Washington enjoyed legal cannabis sales of \$1.37 billion and collected over \$342 million (c.\$445m CAD) in tax, with current monthly tax revenues of around \$30 million.

Oregon (population 4.1m) began sales of recreational cannabis in October 2015. Since then, the state has spent more than \$1.21 billion on legal product, with total monthly sales of between \$45 and \$55 million throughout 2018. Oregon taxes recreational cannabis sales at 17%, with an optional 3% levied by cities and counties, collecting \$20.7 million in the fiscal year to June 2016, \$70.3 million in 2017 and \$82.2 million (CAD\$107m) in 2018.

US states have chosen to establish a direct link between cannabis tax revenue and public service provision. In Oregon, the state school fund receives 40% of cannabis tax take, with

mental health, alcoholism and drug services allotted a further 20%, state policing 15% and the health authority 5%. In Colorado, recipients include the state's school building fund, the education department and local law enforcement, with revenue supporting projects such as cannabis education campaigns and substance abuse protection programs. While cannabis tax revenues may be small relative to state's overall budgets, coupling them to specific agencies and programs helps to underscore legalizations positive contribution to wider society.

JOBS

The legal cannabis industry has also generated thousands of jobs in each of the three states.

A study of Colorado's cannabis industry found it created the equivalent of 18,000 new full-time positions in 2015. Of these, over 12,500 were in the plant-touching sectors of cultivation, processing and retail, with an additional 2,900 jobs in ancillary industries such as security, real estate, construction and legal services. A further 2,500 jobs represented 'induced employment', generated by cannabis business owners and employees spending income on local housing, food and entertainment. The success of Colorado's legal weed industry is even thought to be a key reason for the state enjoying one of the lowest unemployment rates in the USA.

As a first mover in the industry, Colorado's Front Range has experienced a burst of cannabis business formation in technology, manufacturing and testing - earning the area the nickname 'the Silicon Valley of Cannabis'. More so than other US states, Colorado has also harnessed the power of cannabis tourism. Canna-curious visitors can book a range of tours, experiences and 420-friendly accommodation, with some 6.5 million cannabis tourists clocking nearly 18 million use-days in 2016.

In Oregon, legislation has also created an estimated 12,500 plant-touching jobs, generating over \$315 million in wages and \$1.2 billion in broader economic activity. In Washington, active cannabis businesses employ the average equivalent of 9 full-time workers, and have generated more than 6,000 full-time equivalent jobs with total wages of \$280 million. Neither figures given for these states include job creation in ancillary and secondary sectors, with the full employment effect of each industry therefore even higher.

PRODUCT CHOICE

In Colorado, Washington and Oregon, recreational legalization has been characterised by an explosion in product innovation, variety, branding and consumer choice.

Cannabis consumers in each state are served by roughly 500 private retail stores: In Washington, the number is capped and distributed across counties, while Colorado and Oregon impose no state limit.

Given similar population sizes and use rates, this offers a ballpark figure for the total

number of stores that BC - which has similarly uncapped retail numbers - might enjoy. This number is likely higher than the previous level of black-market dispensaries across BC, but will depend significantly on the restrictions and attitudes of local and municipal government. A month on from legalization and nearly 300 private retail applications have been submitted in BC, although only one private retail license has so far been granted.

Across the US states, thousands of products jostle in dispensaries for the attention of every kind of cannabis connoisseur - free from Canada's federal packaging requirements, products range in presentation from the sleek and stylish to the brash and the bold. As product choice and consumer preferences develop, users increasingly look for more than a simple smoke - flower's proportion of total sales continues to decline and hovers around 50% in all three states, while concentrates claim roughly 25% of the markets, and edibles another 10-15%. From Gorilla Glue vape pens, THC-infused coffee to CBD gummies, chances are that these markets can satisfy even the most specific of urges.

Colorado's legal cannabis industry is home to 275 brands and 11,000 unique products, according to retail tracking data from 2016 and 2017. In Oregon, total product offerings grew by over 1,000% in the first six months of legalization, with over 400 brands and 10,000 products on sale within the state. Not one to be outdone, Washington State offers more brands and products than these two states combined: in this heavily-contested cannabis market, over 1,000 cannabis brands and 45,000 unique products were tracked over the same period.

Despite the sheer level of diversity, retail competition has also resulted in clear commercial winners. While no single product holds more than a few percent market share, a handful of firms have grown to dominate the easily-branded markets for edibles and concentrates - in each of the three states, the top 10 edible brands hold a 70% market share, while in Colorado and vape-heavy Oregon the top 5 concentrates brands alone account for 70% of the market. This shows that brand identity is indeed valuable in the commercial cannabis space, and that those with a good product and a strong image can succeed against even thousands of competitors.

MARKET STRUCTURE

The competitive retail environments in Colorado, Washington and Oregon are underpinned by their broader free-market structure, with significant competition at the cultivation level and, in contrast to BC's own legal industry, a commercial marketplace void of government intervention.

Each of the three states exhibit a crowded and competitive cultivation sector, largely by intentional design. In Oregon, relatively low barriers to entry were seen as a way to establish legitimacy and bring black market growers into the new legal framework, while Washington regulators chose to regulate licenses at a retail rather than a producer or processor level. None of the three states have capped the total number of production licenses, with licenses instead limited by either plant size or canopy count. Colorado now

has more than 700 sites licensed for recreational cultivation alone, while Oregon and Washington State both have more than 1,000 cultivators each.

When it comes to the sale and distribution cannabis in the US states, it is treated like any other consumer good. In contrast to BC's interventionist model - where the Liquor Distribution Branch determines the exact brand assortment, volume and wholesale price of the province's cannabis - in Colorado, Washington and Oregon, individual producers and retailers negotiate supply agreements and wholesale prices amongst themselves.

Aided by online brokerage platforms such as Cannabase and Green Marimba or, in Oregon, one of 130 private cannabis wholesalers, cultivators and retailers are free to contract for the product volume and price they wish on a fluid and responsive basis. With cultivators and processors free to sell direct to retailers without government approval, pricing or intervention, competition is fierce, quality is high and the price responds to market conditions.

Precise market structures vary between the three US states: In Colorado, the vertical integration of cultivation and retail was mandated for the first few months of legalization and is now optional. The same applies in Oregon, whereas vertical integration is strictly prohibited in Washington State. Yet despite these differences in retail structure, a functioning commercial market unites the three states and distinguishes them from Canadian models defined by provincial economic control.

In Canada's cannabis industry, high barriers to entry and economies of scale mean that the number of LPs competing for national market share and multi-provincial supply deals will remain far lower than the level of cultivators in US states. However, Canada's new micro-cultivation and processing licenses open the door for a groundswell of craft and boutique production focused predominantly at a local and provincial level, similar to growers in Colorado, Washington and Oregon.

While micro-businesses can inject more diversity into Canada's legal cannabis industry, without the open marketplace enjoyed by US states, craft producers in BC face far less opportunity to even access the consumer market, let alone succeed in it.

PRICE

The competitiveness and ease of entry for US states' cannabis markets have also had a defining impact on the price of legal weed.

Across each state, the onset of legalization was characterised by high retail and wholesale prices as new licensed production struggled to keep up with legal demand. As growing practices have improved, the number of has cultivators risen and supply has continued to increase, cannabis prices have fallen across the board.

Wholesale prices peaked in Colorado in early 2015, with a pound of bud reaching an average of \$2,000. Since then, prices have continued to fall to an average of \$760 per

pound of bud, \$325 for trim, and \$225 for flower used in extractions. Retail prices in Washington State have gone from more than \$30 a gram for flower to less than a third of this initial price, while wholesale prices have fallen to under \$600 a pound.

Oregon's cannabis market has been particularly volatile: initial scarcity and a poor harvest were followed by a flood of new capacity, triggering a steep drop in wholesale prices within 18 months of recreational sales. Retail prices in Oregon peaked in late 2015, with the average, pre-tax retail price for a gram of flower down 36% over the past two and a half years to \$6.50.

Alongside plummeting prices, Oregon's market is marked by significant oversupply: according to the state tracking system, there is over 1 million pounds of unsold legal cannabis and edibles in state inventories - nearly three times the total amount of cannabis sold in Oregon over the whole of 2017.

Low prices are a boon for consumers, but a growing threat to producers: smaller and less-economical operators from Washington and Oregon in particular have been scaling back and winding down as a result of market pressures. Market adjustments can be devastating for individual businesses and entrepreneurs, yet are neither new nor unexpected in such a nascent industry - especially one which generates as much interest and enthusiasm as cannabis.

Both Oregon and Washington regulators were prompted to freeze applications for new cannabis licenses this summer, thanks to a backlog of applications and rising concern over market oversaturation. But even without government intervention growers across the three states are finding ways to adjust - for example, by growing for the flower-intensive extraction market, switching to CBD-rich hemp production, or segmenting to high-grade flower and value-added products, which continue to attract a strong price premium. Growers are also responding by regulating their total output: in Colorado, recreational cultivators currently utilize only a third of their total allowable plant count.

Overproduction and plummeting prices have led some to deride 'too much of a good thing' in Oregon and Washington, often while criticising regulators' 'hands off' approaches to cultivation management in the states. While it may be tempting to blame market saturation on the failing of an under-regulated, free-market approach to cannabis production, it's worth considering whether the inverse - underproduction, overregulation and legal prices far beyond that of the street dealer - are preferable instead.

It's also worth noting that warnings of looming overproduction are given for the comparatively highly-regulated industry of Canada, too - although in this instance driven by the output of a handful of large cultivators rather than a plurality of smaller growers.

THE BLACK MARKET

Colorado has enjoyed significant success tackling the cannabis black market, and four years on from legal sales has the lowest black market rates in the USA. Legal consumption now accounts for two-thirds of sales in the state, with the black market projected to be fully eliminated by 2020.

In Washington state, legal sales now account for between 50% to 65% of the market, while the black market remains more persistent in Oregon, representing an estimated 60% of sales.

Although there is still some way to go until the black market is fully eliminated, these figures reflect a significant transition of illicit cannabis production and use into the regulated system - and offer a benchmark against which Canada can measure its own progress eroding illegal sales.

Cannabis black markets continue to persist in the US states for several reasons. High tax rates which make legal sales uncompetitive are one, as in the early days of Washington's legalization, and Colorado's recent tax increase also blamed for a slowdown in black market erosion. Poor enforcement, including understaffed government agencies - and in the case of Washington, a meltdown of the state tracking software - is another.

Lack of access to legal cannabis remains a significant driver of the black market. In Washington, 30% of the state's population live in an area banning cannabis retail, while in Colorado 65% of local jurisdictions have prohibited cannabis cultivators and stores. Similarly, 80 cities and 16 of Oregon's 36 counties prohibit any kind of marijuana business.

With online delivery prohibited across each of the three states, the black market is often not just the best but the only source of cannabis in 'dry' locations. Even in jurisdictions with legal retail, the convenience of illegal delivery services remain a draw: of the three states, only Oregon allows deliveries by dispensaries, leaving consumers in cities like Seattle and Denver turning to neighbourhood dealers for 'pizza-style' home delivery.

However, the biggest reason for the persistence of the black market is an uniquely American one: the federal illegality of cannabis. Demand for weed in other states has not disappeared, and the market - legal or otherwise - is happy to oblige.

Falling prices in legalized jurisdictions with a continued price premium for cannabis in other states creates a lucrative opportunity for interstate trafficking. Faced with low prices and excess production, licensed growers have fuelled diversion by offloading product on the black market, as have retail consumers seeking arbitrage opportunities across state lines. Law enforcement have also reported an increase in organised illegal grows in legal states, with criminal enterprises using legalization as cover to operate in plain sight.

Like BC, Oregon has long enjoyed a reputation for high-quality cannabis production and notoriety for distribution beyond its borders. This in part accounts for the Beaver State's

comparatively robust black market: while the opportunities and reasons for supplying Oregon's domestic market have been reduced, there has been relatively little incentive to pack up existing trafficking arrangements.

Over time, increasing access to legal cannabis across the USA will dampen demand for diverted product, though the problem will likely persist until policy change at the federal level. However, continued trafficking is a trend that Canadian (and particularly BC) policymakers should be aware of, although the focus here is likely international rather than internal.

A HIGH BAR TO BEAT

Although not without hiccups, the successful cannabis economies of Colorado, Washington and Oregon show that legalization can be a catalyst for growth, jobs, public revenue and opportunity.

Under these states' largely free-market models, consumer choice and product innovation have flourished and cannabis prices have plunged so low as to force former dealers into the painful world of actual jobs .

This has all been achieved despite the fact that cannabis' federal illegality strips American cannabis businesses of banking facilities, imposes prohibitively high tax rates, and severely restricts opportunities for out-of-state expansion. In this respect, Canadian canna-preneurs are blessed with a far more accommodating business environment and enjoy greater financial opportunities than their American counterparts.

US states have also made great strides in eroding the black market, with the clear majority of producers and consumers enthusiastically embracing the legal, regulated industry. However, their experience demonstrates that aspects of the illicit market will continue to persist if there is incentive enough for their existence.

Just as trafficking opportunities and questions of consumer access keep a black market rumbling in legal US states, so too do issues of access, choice and diversion pose a threat to the new industry in BC.

Yet the experience in US states can only reveal so much. Colorado, Washington and Oregon have embraced an open market of cannabis production and sale, whereas British Columbia (like many other Canadian provinces) has opted for a model of provincial government control.

In diverging from the American experience, BC regulators may gain more influence over elements of the industry, but at a potential cost. While US states enjoy competition, innovation and a thriving legal industry, some of the biggest risks to BC are that overbearing provincial control will stunt craft production and consumer choice, new economic opportunities fall by the wayside, and the black market endures.



**COSTS AND
OPPORTUNITIES OF
DIFFERENT LEGAL
CANNABIS MARKET
MODELS IN
BRITISH COLUMBIA**

A SPECTRUM OF CONTROL

Canada's Cannabis Act divides the responsibility for cannabis regulation between the federal government and the provinces and territories. While the federal government is responsible for licensing cannabis producers and regulating the production of cannabis products, the provinces and territories have been tasked with determining their own system of cannabis distribution and retail.

The provincial and territorial governments have adopted a range of regulatory frameworks, each reflecting local character, context, and political considerations. Models range from total provincial control of cannabis distribution and retail, as in New Brunswick, Nova Scotia, and Quebec, to the entirely private distribution and retail framework of Saskatchewan. All provinces, with the exception of Saskatchewan and Manitoba, offer online sales exclusively through their public wholesale distributor.

British Columbia has opted for a 'hybrid' model of cannabis distribution and retail, mirroring the province's three-tier alcohol system. The BC Liquor Distribution Branch (LDB) is the sole, wholesale distributor of recreational cannabis for the province, and the only entity from which retail stores can purchase recreational cannabis in BC. The province allows for both government-run and private retail sales, although the vertical integration of production and retail ownership is prohibited, with online recreational sales hosted and fulfilled by the LDB.

THE CASE FOR A MONOPOLY WHOLESALER

BC is far from unique in having a provincial wholesaler, with every province and territory except for Saskatchewan adopting a similar approach. The rationale for doing so is largely one of control, offering the provincial government significant influence over the supply, pricing, and range of recreational cannabis available in BC.

PUBLIC BENEFIT

As a monopoly wholesaler, the LDB can act to ensure that federal and provincial policy goals are pursued. Non-profit-seeking in the traditional sense, the public interest can therefore be placed above financial success. As a crown corporation it is also accountable to the public, and political pressure and reform can be used to address concerns in a democratic manner.

Commercial crown corporations such as the LDB also provide a reliable source of revenue for public coffers, with the LDB generating \$1.25 billion for local government in revenue, taxes and licenses from \$3.5 billion of sales in 2017/18.

In addition to collecting revenue from government-run cannabis retail stores and online sales, the LDB's wholesale monopoly enables the board to act as a price setter - in this case applying a 15% markup to products it sells onto retailers. If 50% of BC's estimated 91 tons of cannabis consumption is through legal recreational channels in 2019 and landed wholesale costs of \$5 a gram are assumed, the LDB will generate \$34 million in cannabis wholesale revenue alone.

The LDB's new cannabis division also provides a source of unionized employment - with its Richmond distribution facility employing 130 staff in roles including logistics, shipping and receiving, and customer care - and the facility is centrally tracked and monitored, streamlining compliance issues and minimising inspection costs.

BLACK MARKET COMPETITION

As a provincial monopsony (the sole buyer), the LDB is able to effectively 'set a price' for adult-use cannabis in BC. In placing high-volume orders of thousands of kilograms, the LDB is well-positioned to negotiate with LPs on pricing, and to secure a price that is competitive with the black market.

The LDB has also chosen to impose a flat 15% markup on the price for cannabis it supplies to retail stores. Far below BC's 124% markup on spirits and 89% on wine, this uniform rate has been chosen to help legal retail remain competitive with the black market.

STABILITY AND STRATEGY

Canada is expected to experience a similar pattern of legal cannabis supply to that of US states: an initial supply shortage at the outset of legalization, followed by significant increase in production and potential oversupply.

While this has resulted in large fluctuations in supply and price in US states, provincial monopoly wholesalers can effectively 'fix' the supply of legal recreational cannabis and provide a guaranteed price to LPs for product. The LDB has also set a minimum price for sales, below which retailers cannot go below.

The effective management of supply and consumer demand by the LDB would help to ensure an adequate cannabis supply within BC, avoiding significant gluts or droughts of legal product.

As a monopoly wholesaler and price setter, successful LDB intervention can ensure that retail prices do not fall so low as to encourage cannabis consumption or illegal diversion, while allaying some of the difficulties that farmers in the US have faced with fluctuating wholesale prices.

A provincial wholesaler such as the LDB can also use its monopoly power to establish a level playing field in the retail arena, ensuring that a wide variety of products from a range of producers across the country are available.

Alternatively, the LDB could use its purchasing power to actively promote or give greater consideration to BC brands - for example, by giving LPs situated in BC preference when negotiating supply agreements, or allocating a certain proportion of supply to local craft or micro producers.

AGAINST BC'S HYBRID MODEL: AN OUTDATED SOLUTION TO A MODERN MARKET

However, many of the benefits of the LDB's role outlined above - supply management, competition with the black market and the pursuit of strategic objectives - presuppose that a monopoly wholesaler is the most effective method to achieve these ends. Yet it's far from evident that the LDB - or any form of monopoly wholesaler - will be.

BC's Liquor Distribution Board has its roots in the history and hangups of North American alcohol prohibition. While there's something poetic about handing the same government body control of yet another failed prohibition product nearly one hundred years on, it reflects a failure to update our thinking on the control and treatment of 'vices' beyond the early 20th century.

Suppliers, private retailers, and the entertainment industry have long complained about the flaws of BC's legacy alcohol monopoly - a system characterised by opacity, inefficiency and delays, difficulties with specialty orders, some of the most expensive alcohol prices in the world and a reportedly ingrained culture of control hostile to reform.

Former Vancouver Mayor Sam Sullivan has admitted that "there's no good reason for our government to be in the liquor business" - so why should cannabis, with a far lower risk profile and significantly lower use rates than alcohol be any different?

NOT GETTING HIGH OFF THE GOVERNMENT'S SUPPLY:

Government wholesalers face the unenviable tasks of securing the right variety and volume of legal cannabis to satisfy the province, and ensuring that this is rapidly distributed to consumers and retailers.

One month in and already strains on the systems were beginning to show: more than 1,000 customers have reported the Ontario Cannabis Store to the provincial ombudsman after having to wait up to several weeks for the delivery of their orders, with Ontario Finance Minister Vic Fedeli blaming the province's difficulties on 'lying criminals' failing to fully report the true scale of black market demand. More than half of the government-run stores in New Brunswick have been forced to temporarily close due to a lack of supply, while Quebec cannabis stores are closed three days a week as a result of chronic shortages.

This not solely the fault of wholesalers like the LDB: while the early days of legalization correspond with a surge of order to a new, untested system, LPs are themselves undergoing a steep learning curve. Several large LPs are delayed in fulfilling their supply agreements, citing reasons from supply chain issues and a lack of staff to low crop yields and mismanaged inventories as the cause.

However, the province's reliance on a single, institutional wholesaler and only a handful of LPs highlights a crucial weak spot in the current system.

When the cannabis market operates freely, as in legal US states, many hundreds of producers and retailers can connect to identify pockets of supply and consumer demand. Faced with supply shortages, cultivators with available cannabis can simply sell it to a processor or retailer, likely charging a premium for the scarcity of their product.

Under the LDB wholesale model, no such simple responsiveness or flexibility exists: LPs and retailers cannot directly negotiate a supply agreement, no matter how local or convenient the arrangement may be, and LPs are unable to sell directly to recreational users in any capacity.

Instead, the entire system relies on the existing arrangements between a few dozen LPs and the LDB, with the body looking to secure new agreements with producers periodically throughout the year. It is entirely understandable that in servicing the consumers and retailers of an entire province the LDB would want to fully understand a producer, their products and the likely consumer demand, but it is a woefully glacial system when faced with issues of immediate supply shortages.

GOVERNMENT WEED = BORING WEED

Shortages aside, BC's legal industry needs to offer more than just competitive prices if it is to rival the variety and quality of the black market.

The LDB online store currently offers over 200 products from nearly 30 licensed producers. While this compares favourably to the assortment offered by a single online or bricks-and-mortar dispensary, it is a far cry from the many thousands of legal products available in America's recreational markets.

For BC's legal market to provide even a reasonable comparison to states like Colorado and Washington, the LDB's stock selection will need to increase many times over. The LDB often reiterates its commitment to achieving range and diversity in its product offerings, but it is difficult to reconcile the economics of the LDB - a bulk wholesaler servicing every customer and future retailer in the province - with that of a boutique or micro-grower.

Craft growers are likely to have higher production costs than industrially-scaled operations, as well as significantly more limited output (the holder of a microprocessor license, for example, is limited to processing no more than 600kgs of dried cannabis or the output of a sole micro-cultivator). This raises questions of how economical it will be for the LDB to enter into supply agreements with craft and micro-processors, as well as practical issues of how relatively small levels of production can be made available both on a wholesale level to all retailers and online to customers.

There is undeniable value in leveraging the LDB's purchasing power for large orders with competitive wholesale rates. However, if the procurement of safe, bulk and value cannabis products is the LDB's sole focus, then smaller, value and craft offerings risk being overshadowed in the name of volume.

There is evidence that this may already be happening: In supply negotiations the LDB is reported to have offered producers between \$2.50 and \$4 per gram wholesale, compared to prices of between \$5-\$6 per gram from other provinces.

Cannabis consumers are diverse in age, income, use, and preferences. The unfortunate result of a one-size-fits-all wholesale model is the risk of a poorer and more narrowly-focused range of products, less in-province innovation, and frankly- boring weed.

RESTRICTED RETAIL AND SUPPRESSED CONSUMERS

This homogeneous assortment of offerings impacts the retail environment too - whether in a private store, public store or online, the products offered to BC consumers will be the same.

By artificially restricting the range of legal products available to customers, the LDB's monopoly impacts retailer's ability to compete for customers and to differentiate themselves in variety and experience. Entrepreneurial agency, profit opportunities, and the incentive to invest in BC's cannabis ecosystem are therefore all reduced - and at the end of the day, with the black market most likely benefitting.

BC's limited retail structure further reduces opportunities for cultivators to access the market, retailers to offer value-added, and for consumers to enjoy greater convenience.

The province's prohibition on deliveries by private dispensaries leaves a popular 'on demand' niche of the black market unfulfilled, while restrictions at the LP level - on farm gate sales and direct-to-consumer online - prevent growers from forging a direct relationship with consumers and from offering product on a smaller, more targeted scale without the hurdles of negotiating a province-wide supply agreement.

THE BEST OF BOTH WORLDS

The Cannabis Act was passed to prevent youth access to cannabis, protect public health and safety, and drive out organised crime. While the province has an important responsibility to support these aims, policymakers should be also overwhelmingly focused on helping the legal cannabis industry take root and flourish in BC.

Ensuring the integrity of the legal industry and aiding its economic success are not mutually exclusive goals, yet with too restrictive and unadaptive a regulatory regime, the full benefits of legalization will fail to materialise.

Despite the best intentions of policymakers and the sincere efforts of the LDB, the body will struggle to match the efficiency and responsiveness of a free-market allocation of cannabis like that of US states, while the province's broader retail restrictions constrict consumer choice and market access, particularly for smaller and craft growers.

This is not to say that the role of provincial wholesaler is without merit: the LDB is uniquely positioned to purchase and distribute a high volume of cannabis products, provide a baseline of variety and supply for the province, and leverage its purchasing power and price-setting abilities to compete on value with the black market. However, none of these advantages of the LDB in fact require it to possess an entire monopoly on wholesale, or preclude the expansion of current retail options.

If the BC government is truly committed to eroding the province's black market and taking full advantages of legalization, it should look to the market to expand and augment the work of the LDB.

The introduction of even limited new supply channels and elements of private distribution would expand choice for retailers and consumers, and help alleviate distribution holdups and shortages of supply. The additional introduction of wider retail options - closer reflecting those available for the craft beer and provincial wine industry - would increase commercial opportunities for smaller growers, drive adoption of the legal market, and could lay the foundation for a responsible cannabis tourism industry in BC.

BC has already reflected its unique character and history in adopting a hybrid model of retail unseen in any other province - to truly harness the potential strength of British Columbia's legal industry, the province should look to further enjoy the best of both worlds and truly hybridise the cannabis supply chain.



**THE EVIDENCE-BASED
CASE FOR A HYBRIDIZED
SUPPLY CHAIN FOR
LEGAL CANNABIS IN
BRITISH COLUMBIA**

The proposals below are designed to supplement (and at times compete with) the LDB's role in cannabis distribution, and could be adopted individually or in combination with each other.

Each policy reform would introduce private supply chains and greater market mechanisms into BC's distribution and retail model, but could co-exist alongside the current framework of LDB distribution and public/private mix of retail stores.

The reforms are offered with a number of goals in mind: to encourage growers into the legal market and give producers the maximum chance to succeed, to reduce the incentives for black market use, to shore up cannabis supply, drive tourism, and support a diverse and sustainable cannabis industry which reflects the true spirit and history of BC.

FARM GATE SALES

The introduction of 'farm gate' or direct sales would allow LPs to offer on-site sales of product at their facility.

Similar to tasting rooms at brew pubs and wineries throughout the province, consumers would be able to visit LPs to see where their cannabis was cultivated and processed, and engage with staff directly onsite who could provide information and advice about the products on offer.

So far there is only one example of cannabis farm gate sales in the whole of Canada - a Tweed store in St John's, Newfoundland - while Ontario's retail model will restrict LPs to operating a single retail store at their production facility only.

Crucially, farm gate sales could be introduced for BC LPs without the need for growers to enter large supply agreements with the LDB. This would be of particular benefit for micro-licence holders with limited output, and could reduce costs and complexity for the LDB.

The model for farm gate sales could be similar to that of brewpubs, where an accountancy workaround allows producers to sell and repurchase product from the LDB without it leaving the facility.

The LDB could then choose to apply the 15% cannabis wholesale markup to farm gate sales, maintaining revenues and an even playing field, or waive the tax to support local production and community tourism.

Benefits

A farm gate model would uniquely benefit BC growers, and could help encourage new legal operations in the province. It would also provide a valuable source of income for smaller craft cultivators and help them to establish a local community base, while allowing LPs to directly capture retail profits.

Farm gate sales would help LPs to forge a direct relationship with consumers, enhancing consumer education while capturing valuable information on customer preferences and

feedback. In providing a memorable experience, it also highlights a craft, community approach to cultivation, allowing brand identity and loyalty to be built while encouraging a responsible and engaged approach to cannabis use.

Farm gate sales could also form the cornerstone of a vibrant, BC-style canna-tourism, as well as generating positive knock-on benefits for local businesses such as restaurants and hotels. With the province's wineries attracting one million visitors a year, there is legitimate scope for craft cannabis tourism to flourish as its own industry, and could be introduced as part of a broader BC-wide development strategy.

Drawbacks

Farm gate sales are not a panacea, however. They are likely to represent only a small proportion of sales for most LPs, and of the BC market in total. And absent of a wider tourism drive, farm gate sales will serve a relatively small population of local consumers only.

Crucially, establishing farm gate sales will also require the support of local municipalities, many of which may be opposed to the idea and who would have the ability to veto applications. Farm gate sales may also increase the regulatory burden on the LDB, who will need to ensure that rules on packaging and quality testing are adhered to onsite.

Finally, farm gate sales represent a form of vertical integration - which some deem controversial - and may open calls for off-site vertical integration in the future.

LP TO CONSUMER ONLINE SALES

Under this model, BC residents would be permitted to purchase cannabis online directly from the websites of Licensed Producers.

The system would represent an near-identical extension of the existing medical online model, where customers register online directly with LPs while verifying their age and identity, with additional ID verification required upon delivery.

A number of model variations are possible, with online sales permitted to BC residents from all LPs across Canada, or limited to LPs situated in BC only to ensure compliance.

The LDB could also ensure that the minimum retail price is applied on all online adult-use sales, and collect the equivalent revenue from the LPs.

As with farm gate sales, BC LPs could be permitted to sell direct to BC consumers without the need to enter a broader supply agreement with the LDB. This would be a particular benefit to smaller operations, who could also use online sales as evidence for market demand when negotiating supply deals with other provincial wholesalers.

Benefits

The current medical cannabis system in place is highly successful at preventing access to

minors, and could be easily replicated for a recreational model. Online sales represent a low-cost model for consumers, while also allowing LPs to capture retail margins. Against a backdrop of early shortages for legal product, online sales allow an LP to be responsive and to supply product as soon as it is available. And by smoothing supply shortages and easing consumer frustrations, it would increase incentives for consumers to use the legal market.

Online sales also allow LPs to generate a direct relationship with consumers. Companies could tailor information, offerings and suggestions to their customers, improving user experience and retention while gathering valuable data on consumer profiles, preferences and purchasing habits directly.

In addition, online sales of brands and products not stocked by the LDB would improve consumer access in remote locations and municipalities where retail stores do not operate.

Drawbacks

Given the fact that the LDB already offers online sales, direct adult-use sale may be considered an unnecessary replication by the province. It may also impose extra costs on the LDB in terms of establishing revenue collection of the provincial mark-up, as well as any additional compliance and inspection costs for monitoring private distribution.

The benefits of online sales may also be quite limited if it is permitted for BC producers only, while restriction to in-province production may create difficulties for LPs with multi-province operations or subsidiaries.

PRIVATE RETAIL TO CONSUMER ONLINE

British Columbia's distribution restrictions could also be eased to allow private cannabis retailers to host their own online store. This would allow cannabis retail stores to operate similarly to private liquor stores, who have been permitted to sell products online and deliver to consumers since October 2016.

Saskatchewan has adopted a retail model of this kind, where a retail licence holder can establish an e-commerce platform serving the entire province, while retailers in Manitoba can also offer an online store and integrated delivery service.

Benefits

Significantly, introducing private online sales and delivery could allow for an on-demand or same-day service for local consumers, rivalling existing black market operations of this kind.

Retailers would be able to serve a geographically wider consumer base, and could offer a wider choice of products than those in store. In addition it may help encourage retail specialisation, with consumers choosing to use a retailer's site for trusted product curation, information and recommendations.

Drawbacks

However, the model of private online sales is somewhat redundant in BC unless retailers can source products from suppliers other than the LDB. (Saskatchewan lacks a provincial wholesaler completely, while Manitoba's government wholesaler does not conduct online sales).

If product is only ordered from the LDB, this model creates an element of inefficiency, with the 'double cost' of warehousing and distribution at both the LDB and the retail level. In addition, it may create additional regulatory and compliance costs for the private delivery of cannabis, especially regarding any 'on demand' orders fulfilled by store staff or a local courier method.

LP TO PRIVATE RETAIL SALES

Building on the concept of online private retail sales, an additional option for reform would be to permit LPs to directly broker supply agreements with private retail stores.

Such reform would eliminate the need for LPs to secure a supply agreement with the LDB in order to be stocked by private retail locations. This would be closest to a free market model of supply and demand, and reflects the supply chain structure in US states where recreational cannabis is legalized. In Saskatchewan, which does not have a provincial wholesale monopoly, LPs are free to enter supply agreements with both licensed private wholesalers and retail stores directly.

So as not to undercut the pricing of the LDB the government could impose a similar markup to private supply agreements, and develop a mechanism to collect a cut of the deal if wished. The scheme could also be restricted in various ways, including permitting B2B sales solely for BC LPs or micro-cultivators. The province could also impose limits on the volume or value of sales agreed in this way, or the number of retail stores an LP can enter into an agreement with.

Benefits

Private supply brokerage would offer a route to market for micro and craft growers with smaller batches and boutique, premium offerings which it may be inconvenient or uneconomical for the LDB to stock. In turn, this could facilitate greater experimentation, innovation, and development of niche cannabis products.

This business-to-business model would allow growers to develop direct relationships with retail stores, and facilitate brand exposure in more populated metro areas. The specialisation of stores could lead to an enhanced 'craft experience' for consumers, increasing the incentive to purchase through legal channels, while allowing retailers to offer 'in-store exclusives' which deliver them value.

In addition, elimination of a wholesale middleman can help move product quickly from where it is produced to where it is in demand, lessening delivery timelines, smoothing supply, and satisfying customers.

Under this model, LDB would free up capacity to focus on its core advantages - negotiating large, bulk orders, and the provision of adult-use cannabis to the broad consumer base at competitive prices.

Drawbacks

However, allowing LPs to negotiate directly with retailers bluntly undermines the concept of a provincial monopoly wholesaler. It may also be considered unfairly disadvantageous to government-run stores, who must then compete against private retail with a smaller range of products.

In addition it may prove overly onerous for small LPs to negotiate with individual retail stores directly, and would require a regulatory framework in place to facilitate and track the private supply agreements.

If retailers appear to have a close relationship with a particular retailer, it could also be considered a method by which to circumvent vertical integration restrictions, and seen as anti-competitive or exclusionary if only limited to BC LPs.

VERTICAL INTEGRATION

Under BC's current regulations, the vertical integration of cannabis cultivation and retail is prohibited. Where there is deemed to be a 'close association' (financial or otherwise) between an LP and a cannabis retail business, the retailer is prohibited from selling any products from that licensed producer.

This has precedence in the alcohol industry, where 'tied house' rules have historically prohibited breweries from selling their own products at businesses they have a financial relationship with. However following provincial reform in 2013, small and medium-sized breweries in BC can have tied-house relationships with up to three offsite bars and restaurants.

BC is unique in offering private cannabis retail while preventing any form of vertical integration: Alberta, Saskatchewan, Manitoba, Ontario and Newfoundland and Labrador all permit licensed producers to operate retail stores, albeit with certain restrictions.

However, the vertical integration of cannabis production and retail is considered controversial in some circles, and is prevented in Washington State and California. To prevent against undue market influence by large Licensed Producers, the province could introduce a number of safeguards, including a requirement for vertically-integrated retail to adhere to the same minimum pricing as other stores. Restrictions could also be placed on the total number of stores an LP holds within the province or a municipality, or a limit calculated from market concentration. In addition, requirements could be introduced for vertically-integrated retail outlets to stock a certain proportion of a competitor's products.

Benefits

In some ways, vertical integration is simply an extension of farm gate sales. Particularly for

smaller or more rural producers, the ability to operate a retail store could provide a valuable source of custom and exposure.

A vertically-integrated operation also allows producers to finely craft their brand experience, from cultivation to final sale. This additional control over brand identity can be particularly valuable to producers, given federal restrictions on cannabis advertising, marketing and packaging.

Similar to farm gate sales, vertical integration enables LPs to access valuable retail data and consumer preferences, which may in turn promote increased and higher-quality R&D. And it also allows producers to capture both cultivation and retail margins from their sales, increasing the profitability of their business.

Drawbacks

There is a chance that unchecked vertical integration could reduce the diversity of stores and products in the marketplace, although regulatory controls could be put in place to lessen the possibility of this. Without them, vertical integration may provide a retail advantage to larger, well-financed LPs at the expense of smaller craft growers.

There is also a chance that vertical integration would spur market consolidation, incentivising the acquisitions of smaller operations by larger businesses.

CONCLUSION

None of the proposals given above are a 'cure-all' to fix every shortcoming of the legal system.

Beyond how BC cannabis is sold, a number of issues face the entire Canadian cannabis industry - such as those of packaging, reliable supply and quality. Nurturing BC's own industry will also require further constructive engagement with municipalities, local government and cannabis sceptics, as well as campaigning for the provision of options such as consumption lounges and cannabis event permits.

However, each one of the reforms offered here would provide new opportunities for producers, increase consumer choice and invigorate BC's legal industry. Taken in combination, the effects could be transformational for the fledgling industry.

BC deserves to lead the provinces when it comes to cannabis entrepreneurialism and progressivism, and deserves a fluid, open model of cannabis sales which enables this.

Without a doubt, British Columbia has the skills, passion and drive to set the standard for a what a successful, responsible and fully-legal cannabis industry looks like. And as we enter the first full year of legalization, it's time to build upon and hone the system to truly let BC shine.

